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John Everett Busch
West Virginia University College of Law

(1950), which held that a corporate officer's expenses are deductible if his business is promoting and investing in various corporations. However, the Tax Court did not say that this was the only instance in which such expenses or debts were deductible. The language in *Wheeler* is strong and direct, but was discounted by the court in the principal case as being too broad. The *Wheeler* case is supported by dictum in *Commissioner v. Smith,* 203 F.2d 310 (2d Cir. 1953).

The Tax Court in the principal case below relied upon *Rollins v. Commissioner,* 276 F.2d 368 (4th Cir. 1960). The court stated that activities of an individual as a stockholder, officer, and director of a corporation in conducting the business of the corporation do not amount to the carrying on of a personal trade or business by the taxpayer. The taxpayer was a lawyer, and this was merely an investment which could not be classified as his trade or business. This employee-investor decision is not controlling upon the facts in the principal case.

The holding that an employee who is required to make advances to his employer as a requisite to his employment may deduct them when they become worthless is equitable, and reasonably interprets the legislative intent behind §§ 162 (a) and 166 (d). A sole proprietor may deduct bad debts arising from his trade or business, and it is unreasonable to assume that Congress would penalize a taxpayer who incurred like expenses because he is not fortunate enough to have his own business. The factual situation which gave rise to this case is a rare one, but it appears that cases arising under similar facts should follow this ruling.

David Mayer Katz

Income Tax—Embezzled Funds Represent Taxable Income

P embezzled 738,000 dollars during the years 1951-1954 and failed to report these amounts as income. Despite a prior Supreme Court ruling which held that embezzled funds are not taxable, *P* was convicted of willful evasion of the federal income tax. The Supreme Court granted certiorari. *Held,* affirmed. Embezzled funds are included as income of the embezzler and subject to federal income tax. *P's* conviction reversed on other grounds. *James v. United States,* 81 S.Ct. 1052 (1961).

Gross income is defined as "all income, from whatever source derived." INT. REV. CODE OF 1954, § 61 (a). This definition is based on the premise that Congress is to use the full measure of its taxing power. It has long been established that unlawful gains are subject to taxation. But a 1946 decision held embezzled money is not taxable. *Commissioner v. Wilcox,* 327 U.S. 404 (1946). The theory of the *Wilcox* decision was that an embezzler received no taxable gain or profit as he had no claim of right to the monies involved, and was obligated to return the embezzled money to its rightful owner. The Court treated embezzled money as a sort of loan which the embezzler was obligated to repay to his "lender." In the principal case the Court overruled *Wilcox.* The taxpayer was here held to have actual command and exclusive control over the property taxed, the benefit for which a tax is paid. The gain was taxable when its recipient derived realizable economic value from it. *Rutkin v. United States,* 343 U.S. 130 (1951). Even though the taxpayer may be liable to restore the gain he has obtained, he has received taxable income. *American Oil v. Burnet,* 286 U.S. 417 (1931).

P, in the principal case, was accused of willful evasion of the federal income tax. As the *Wilcox* case was in force at the time of *P's* act, the Court held the tax evasion was not willful and dismissed the indictment. The dismissal of the indictment and the overruling of the *Wilcox* case was concurred in by six Justices of the Supreme Court.

The dissents were based on various grounds. It was felt the case should be remanded to try the factual question of *P's* willfulness as contrasted with his reliance or misunderstanding of the applicable law as stated in the *Wilcox* case. A major ground of dissent was the manner in which the *Wilcox* case was overruled. The liability of *P* was based on an act of Congress setting forth penalties for tax evasion. Prior to the ruling in the principal case persons who failed to report embezzled money as taxable were not prosecuted. From this decision forward persons will be prosecuted. The dissent argued that a court should not interpret a criminal statute in such a way as to refuse to punish past conduct while creating a prospective penalty. This was considered the creation of a crime, by court interpretation, and an interference with the functions of Congress. It was pointed out in this respect that Congress twice refused to pass bills declaring embezzled monies

taxable. The basic theory of the dissent was the thinking of the majority in the *Wilcox* case, *supra.* It was there held the embezzler received no title to what he took. Contrary to the crimes of extortion, bootlegging, gambling, etc., the owner of embezzled money does not intend the embezzler should receive any title to the monies involved. As soon as an employer realizes his loss he will demand restitution, and the embezzler is obligated to reimburse the employer completely. This is a type of debtor-creditor relationship, as a loan, which is not taxable. The *Burnet* case, *supra,* was distinguished. That case was held to determine when a taxpayer's income is taxable, and did not ascertain what receipts constitute income as such.

The most serious problem in the taxation of an embezzler is the possible priority of a federal tax lien. If money taken by an embezzler is subject to taxes, it is subject to a federal tax lien. This could give the federal government a priority over the person from whom the goods were embezzled. Whenever a person indebted to the United States is insolvent, the debts due to the United States shall be first satisfied. 31 U.S.C. § 191 (1954). This section establishes a general lien on all the property of the debtor. The lien attaches upon the neglect or refusal of the taxpayer to pay the tax upon demand, and relates back to the time of the tax assessment as against unsecured creditors. The lien is not valid against a mortgagee, pledgee, purchaser or judgment creditor until notice is filed in compliance with state law. INT. REV. CODE OF 1954, § 3672. To be valid in West Virginia notice must be filed in the office of the clerk of the county court where the property subject to the lien is located. W. VA. CODE ch. 38, art. 10, § 1 (Michie 1955). See *In re Sport Coal Co.,* 125 F. Supp. 517 (S.D. W. Va. 1954). Knowledge of the victim of the embezzlement that tax was not paid on the funds wrongfully taken will not prevent him from gaining priority by obtaining judgment before the federal lien is filed. It is the date of filing that controls. *United States v. Beaver Run Coal Co.,* 99 F.2d 610 (3d Cir. 1938).

The question arises as to the Government's right to embezzled goods still held by the embezzler. The legal title to the goods is in the person from whom the goods were taken. It has been held that an infirmity in the taxpayer's title, whereby the title could be lost or terminated, will nullify the tax lien. *Fidelity and Deposit Co. v. New York City Housing Authority,* 241 F.2d 142 (2d Cir. 1957).

If money is taken or debts collected from a taxpayer which are the property of a third person, the rightful owner may maintain a suit against the United States to recover the money on an implied contract. *Kirkendall v. United States,* 31 F. Supp. 241 (Ct. Cl. 1940).

The person from whom money is embezzled has some protection in regard to the time a federal lien takes priority. The priority of the Government does not arise until the debtor makes a formal act of insolvency, whether or not federal taxes have been assessed and become liens. *Spokane v. United States,* 279 U.S. 80 (1929). This ruling may give the victim of an embezzlement time to assert a lien so as to prevail over the federal claim. The priority of the federal lien does not apply until the insolvency is shown by a formal act as set forth in 11 U.S.C. § 21 (a) (1952).

In order for a lien to prevail over a claim of the United States, the lien must be more than just capable of being ascertained in the future. The lien must be definite as to (1) the identity of the lienor, (2) the amount of the lien and (3) the property to which it attaches. *Sturgill v. Lovell Lumber Co.,* 136 W. Va. 259, 67 S.E.2d 321 (1951). What is a choate lien is a question of federal law. *United States v. Waddill,* 181 Va. 351, 28 S.E.2d 741 (1945). The federal government has applied a very strict test of choateness. The identity of a lienor is no problem. The courts have, however, found quite petty reasons to declare the amount of a lien uncertain. A lien may well not be considered choate unless there has been a final judgment deciding beyond controversy the amount due. It also seems that a lien on the most precisely identified personal property is not choate within the federal meaning until the identity of the property is fixed beyond controversy or judicial review. 13 TAX L. REV. 475 (1958).

The person from whom funds are embezzled is faced with the task of becoming a judgment creditor and levying upon specific property before a federal tax lien is filed. The embezzler now is subject to prosecution by both the federal and state government. The decision in the principal case may well be said to burden both the innocent and the guilty when an embezzlement is discovered.

John Everett Busch